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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM. 1962

NO. [redacted] 180

T. W. and EVELYN B. WHEELER,
Petitioners,

VS.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE
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T. W. and EVELYN B. WHEELER,
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VS.

UNITED STATES OF AMERICA,
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NO.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above entitled action on December 11, 1962, reversing the judgment of the United States District Court for the Western District of Texas and remanding the case to that court for further proceedings.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported in 311 F. 2d 60. It is attached as Appendix A to this petition at page 31.

The memorandum opinion of the District Court for the Western District of Texas has not been reported but is set out at T 166. [1] The findings of fact and conclusions of law of the United States District Court for

[1] References preceded by "T" are to the certified transcript of record filed herein. Any references to "T" 1-194 may also be found on the corresponding pages of the record as printed for use of the Court below, 9 copies of which have been filed here.

the Western District of Texas are set out at T 168-172, and the judgment of the United States District Court for the Western District of Texas appears at T 173-174.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit (Appendix B, infra, p. 48) was entered on December 11, 1962. A petition for rehearing (Appendix C, infra, p. 49) was denied on February 27, 1963. The jurisdiction of this Court is invoked under the provisions of 28 U.S.C., Section 1254 (1).

QUESTIONS PRESENTED

1. Whether one of several alternate grounds for refund advanced by a taxpayer [2] in his claim for refund filed in conformity with §7422 (a) of the Internal Revenue Code of 1954 and Treasury Regulations § 301.6402-2 (b)(1) may be, as a matter of law, a conclusive admission against taxpayer's interests.

2. Whether one of several alternate grounds advanced by plaintiff in his complaint in conformity with Rule 8(e), Federal Rules of Civil Procedure, may be, as a matter of law, a conclusive admission against plaintiff's interests.

3. Whether a United States Court of Appeals may ignore all of the evidence of record, admitted without valid objection, in order to reverse the findings of fact by a United States District Court as being clearly erroneous.

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[2] Evelyn B. Wheeler is a party to this action only because she and her husband filed a joint income tax return. Therefore, as used in this brief the word "taxpayer" or "petitioner" refers only to T. W. Wheeler.

4. Whether payments made by taxpayer in compromise of a suit against him for an injunction, a receivership over three of his corporations, for specific performance of a contract to sell the controlling stock interest in the three said corporations, and for legal expenses incurred in defending the suit, constitute currently deductible expenses for the management, conservation or maintenance of property held for the production of income or constitute non-deductible capital expenditures to be added to the cost basis of the corporate stock.

STATUTES, REGULATIONS AND RULES INVOLVED

The statutes, rules and regulations involved are set out is Appendix E, *infra*, p. 59.

STATEMENT OF THE CASE

In 1953, taxpayer owned the controlling interest in three separate corporations, viz.: Alamo Motor Lines, Wheeler Investment Corporation, and Alamo Terminals, Inc. (T 77, 169.) He discussed selling the stock of those corporations to Ben Jack Cage, and taxpayer drafted a proposed contract of sale. However, the contract was not consummated at that time because taxpayer was notified by Cage's attorney, Carl Phinney, that Cage was no longer interested in buying the stock. (This representation by Phinney was false; Cage still wished to buy the stock. T 91, 92.) Phinney also informed taxpayer that there was another prospective buyer available - a man named Ainsworth. (T 77 - 78.)

Taxpayer then entered into negotiations with Ainsworth and finally executed a contract of sale on May 6, 1953. (T 79, 169.) In consideration for the

stock. Ainsworth contracted to pay taxpayer one million dollars ($200,000.00 in cash and the balance by a promissory note bearing interest). (T. 159.) The contract of sale had been drawn by the attorney for the purchaser, Carl Phinney, (T 78) who also acted for the taxpayer and advised the taxpayer that he was fully protected by law. (T 83.) The contract provided that the purchaser was not personally liable for the purchase price, (T 164) and further provided that purchaser Ainsworth's promissory note for $800,000.00 was to be secured by a pledge of the stock of the three corporations but that such stock might be pledged by purchaser for a loan up to $250,000.00 which would take priority over taxpayer's security. (T 161.) The proposed note for $800,000.00 provided that taxpayer should have no recourse on A. G. Ainsworth for default. (T 147, 158.) The collateral pledge agreement contained similar provisions relieving the purchaser of all personal liability (T 154, 164-165) and subordinating taxpayer's pledged security to pledges of the same stock to the Capitol National Bank in Austin, Texas, for up to $250,000.00. (T 155, 160-161, 162.)

Subsequently, but prior to closing the deal, taxpayer was advised by another attorney that the contract of sale did not protect him. (T 86.) Taxpayer then notified Ainsworth that he would not go through with the contract of sale (T 108-109, 169), and, on May 20, 1953, Ainsworth filed suit against taxpayer. In said suit, Ainsworth prayed for the issuance of a temporary restraining order, a temporary injunction restraining taxpayer from disposing of the stock, the appointment of a temporary receiver of all three of taxpayer's corporations, and the specific performance of

the contract of sale. (T 129-130, 169-170.)

Prior to the contracts and suit, the taxpayer, through and on behalf of his corporation, had been borrowing between $20,000.00 and $60,000.00 a week. (T 90.) A receivership would have cut off the credit and put the taxpayer and his corporations out of business. (T 89.)

The request for a temporary restraining order was granted. On June 4, 1953, immediately prior to the hearing on Ainsworth's request for a temporary injunction and a temporary receiver, taxpayer settled the dispute by paying Ainsworth $54,675.95. Taxpayer paid attorney's fees with regard to that suit in the amount of $1,965.46. (T 170.) Taxpayer testified that he had been advised by his attorney, Mr. Robinson, that he could win the suit for specific performance. (T 88.) Taxpayer further testified without valid objection or contradiction that he compromised and paid the amounts involved to avoid a receivership which would have injured or destroyed the credit of his corporations. (T 89.) Following the settlement of the Ainsworth lawsuit, taxpayer sold the corporate stock to a corporation controlled by Ben Jack Cage for one million dollars - - the same amount originally offered by Ainsworth. (T 43-56, 94.)

In his federal income tax return for the fiscal year ending August 31, 1953, taxpayer took a deduction for the $54,675.95 paid to Ainsworth in settlement of the suit for a temporary receiver, and an additional deduction for the $1,965.46 incurred legal expenses. The Commissioner disallowed the deductions of those amounts but added such amounts to taxpayer's basis in the stock, and a deficiency of $28,733.74 was assessed

and paid by taxpayer on June 28, 1957. Taxpayer filed a timely claim for refund on June 10, 1958, and instituted suit for refund more than six months thereafter. (T 110-111.)

Upon trial of the cause in the United States District Court for the Western District of Texas before Judge Ben H. Rice, the court held that the settlement cost and attorney fees were ordinary and necessary expenses paid for the management, conservation and maintenance of property held for the production of income (T 171) and entered judgment for taxpayer Wheeler. (T. 172.) The Court made findings of fact which were based upon the undisputed testimony of taxpayer T. W. Wheeler as follows:

XV.

"That T. W. Wheeler refused to fulfill the contract of sale after an attorney had explained to him that under the last paragraph thereof, the vendee could take the corporations and completely deplete them and hand the stock back to Wheeler without recourse, except for the surrender of the stock to Wheeler upon a complete release of any liability being given to the vendee by Wheeler.

XVI.

"That credit was at all times indispensable to Wheeler in the operation of the business of all of the corporations.

XVII.

"That at the time of the settlement of said law suit, T. W. Wheeler in good faith believed that the appointment of a receiver over the corporations would cut off all credit to the corporations.

XVIII.

"That the reason T. W. Wheeler made the payment of $54,675.95 to A. G. Ainsworth at the time of the settlement of said law suit, was to prevent the appointment of a receiver over the corporations."

On appeal the Court of Appeals properly treated the tax question as arising under 26 U.S.C.A., Sections 212(2) and 263 (a) (1) of the Internal Revenue Code of 1954, which were derived from and substantially identical to Sections 23 (a) (2) and 24 (a) (2) of the Internal Revenue Code of 1939. The Court of Appeals conceded that the taxpayer's motive might be considered in determining the real substance of the settlement transaction, but by majority opinion the Court reversed the Trial Court's findings concerning the taxpayer's motive as being clearly erroneous. The Court's opinion was expressed in the following language:

"In the face of these record commitments, it cannot now be successfully urged that taxpayer's reason for making the settlement was substantially or solely to prevent the appointment of a receiver. That does not accord with the objective facts or with the taxpayer's own statements. We conclude that the payments in question were made by the taxpayer in defense or protection of his title to the stock that was the subject of the suit for specific performance, and were therefore capital expenditures.

The judgment is therefore reversed and the cause remanded." (T 203. Appendix A, infra p. 38).

The Court's opinion rested, as Judge Cameron noted in his dissent, upon the postulate that the testimony of taxpayer T. W. Wheeler was inconsistent with his claim for refund and his complaint. The writings upon which the Court relied are set out below. The unitalicized portions of each statement identify the passages which the Court apparently deemed controlling.

Grounds For Claim.

"Taxpayer made such settlement to prevent:

"(1) the possibility of losing the case which would force him to complete the contract *and cause a tremendous reduction in the value of his property held for the production of income. Taxpayer before the contract was entered into had property held for the production of income (capital stock) amounting in value to* $1,000,000.00. *Should taxpayer have been forced to fulfill the contract of sale his property held for the production of income would have been converted into property (promissory notes) which he feared would have a value much less than their face value due to the anticipated action of the purchaser. Taxpayer wanted to protect his property held for the production of income (capital stock) and to conserve it.*

"(2) *the possibility of placing the corporation in receivership which would damage the corporations heavily, financially and their good-will, and cause taxpayer's property held for the production of income (capital stock) to decrease in value accordingly.*

"*Section 212 of the Internal Revenue Code allows as expenses all ordinary and necessary expenses paid for the management, conservation or maintenance of pro-*

perty held for the production of income. Taxpayer's sole reason for payment of such settlement was to protect and conserve such capital stock, his property held for the production of income." (T 142-143.)

Complaint

"Taxpayers made such settlement to prevent the possibility of losing the case which would force them to complete the contract *and cause a tremendous reduction in the value of their property held for the production of income, and to prevent the possibility of placing the corporation in receivership which would damage the corporations heavily, financially, and their good will, and cause taxpayer's property held for production of income to decrease in value accordingly.*" (T. 4.)

Although the majority opinion of the Court of Appeals did not explicitly state any other grounds for its decision, the dissent by Judge Cameron (T. 204-213, Appendix A, *infra*, p. 31) revealed and clarified the following issues:

(1) The holding and authoritative language in *Levitt & Sons, Inc. v. Nunan*, 142 F. 2d 795 (2nd Cir. 1944) was sufficiently broad for application to the facts of this case, had not been overruled or modified but was not followed by the Court of Appeals for the Fifth Circuit.

(2) The Court of Appeals held that any settlement made to defeat or terminate a lawsuit for the specific performance of a contract to sell personal property constituted a capital expenditure incurred "in defending or perfecting title to property" regardless of

the circumstances in which the settlement was made, so that the mere form in which the lawsuit was cast controlled the substance of the transaction.

REASONS FOR GRANTING THE WRIT

THE COURT OF APPEALS FOR THE FIFTH CIRCUIT HAS RENDERED A DECISION WHICH HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

The decision of the United States Court of Appeals for the Fifth Circuit treated one of taxpayer's alternate claims for refund as a judicial and conclusive admission against interest. The decision attacks accepted principles which have heretofore guided tax practitioners filing a claim for refund under § 7422(a) of the Internal Revenue Code of 1954 and Treasury Regulations § 301.6402-2(b)(1). Consequently, uncertainty has been injected into an area of the law where none should exist. In addition, the Court's interpretation of the petitioner's original complaint in the United States District Court, which complaint complied precisely with Rule 8 (a) and Rule 8 (e) of the Federal Rules of Civil Procedure, apart from being a gross injustice to petitioner, will create hazards, pitfalls, and uncertainty for every plaintiff in every lawsuit filed hereafter in United sidered these questions.

(A) The Court of Appeals by majority opinion held that one of the alternate grounds advanced by taxpayer-petitioner in his claim for refund was legally insufficient and that merely by raising such insufficient

claim, the taxpayer's right to a refund was forfeited. This holding is in conflict with prior decisions of this Court and of every lower Court which has ever considered these questions.

Treasury Regulations § 301.6402-2(b)(1) require a claim for refund to, "... set forth in detail *each ground* upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof." (Emphasis supplied.) Tax practicioners in the past uniformly headed prior cases and official commentaries that, "care should be taken to state the correct theory of the refund, because some courts have held that a claim based on one theory will not support a suit based on another ... Where there is any doubt as to the correct theory underlying the right to refund, alternate theories can and should be asserted." 10 *Merteps, Federal Income Taxation*, § 58.17, pp. 34-36.

This petitioner obeyed the rules applicable to claims for tax refund as uniformly interpreted in such cases as *Alabama By-Products Corporation v. Patterson*, 258 F.2d 892, 900 (5th Cir. 1958), *cert. den.* 358 U.S. 930, and *Carmack v. Scofield*, 201 F.2d 360, 362 (5th Cir. 1953), *cert. den.* 340 U.S. 875, that the taxpayer cannot sue for refund on any ground not raised in the claim for refund. He therefore advanced several theories, only one of which was that he might have lost the suit in question, transferred the corporate stock to Mr. Ainsworth, and later reacquired devalued stock of businesses bled dry by Ainsworth's raids on the capital of the corporation. The legal sufficiency of the grounds so advanced by petitioner is reserved for Sec-

tion II of this petition. At this point it is proper, however, to observe that at the time such alternate claim was made there was substantial legal authority to support the theory and this Court had specifically authorized petitioner to make alternate claims for tax refunds.

In *Kales v. United States*, 115 F.2d 497 (6th Cir. 1940), the Sixth Circuit considered the right of a taxpayer to claim more than one ground for a refund. The Court stated at page 501:

> "... A taxpayer may state as many grounds for refund as he wishes regardless of consistency, provided facts are disclosed on which the Commissioner may act. Compare Reynolds v. McMurray, 10 Cir., 77 F.2d 740; Ferguson v. United States, Ct.Cl., 2 F. Supp. 1012.
>
> "There is a class of claims for refundment of taxes in which, through no fault of his own and often through the fault of the Commissioner, the taxpayer does not know which of two or more inconsistent grounds he may succeed in proving, either of which will entitle him to refundment. In such cases, the taxpayer cannot allege facts without qualification but may state them in the alternative so that the Commissioner, in considering his grounds, will not be left in the dark as to the facts on which the taxpayer relies, but within ilmits, which would exclude abuses, the right of the taxpayer to set up alternative grounds for refundment is clearly recognized. The analogy is found in General Rules of Civil Procedure, 28 U.S.C.A. following section 723c; United States v. Richards, 6 Cir., 79 F.2d 797."

This Court affirmed in *United States v. Kales*, 314 U.S. 186, 196 (1941), stating, "... a taxpayer in his presentation of an informal tax refund claim should be in no less favorable position than the plaintiff in a suit at law who is permitted to plead his cause of action in the alternative."

This Court's decision in the *Kales* case quoted illuminated an area of the law which has never been a problem until now. In *United States v. Pierotti*, 154 F.2d 758 (9th Cir. 1946), the Court of Appeals for the Ninth Circuit had no difficulty in applying the proper rule that, "A taxpayer may state as many grounds for refunds as he wishes, regardless of consistency, provided facts are disclosed on which the Commissioner may act. . . ." 154 F.2d at 761. Only the decision of the Court of Appeals below obstructs the hitherto well-marked highway for the taxpayer. The yawning chasm which this Court of Appeals has opened for future litigants must be closed. *The Alabama By-Products* case and the *Wheeler* case are now two jaws of a trap laid in the Fifth Circuit for every future taxpayer which none can escape unless the *Wheeler* case is reversed.

(B) The decision of the Court of Appeals below also treated certain pleadings by petitioner, which paralleled the alternate claim advanced in his claim for refund, as a conclusive judicial admission. Petitioner's complaint was filed in compliance with Rule 8(a) of the Federal Rules of Civil Procedure and was more concise than his claim for refund. However, the complaint merely repeated and restated the petitioner's theory that by settling the lawsuit he protected his property from the depredations of a corporate raider.

No "value" was added to the property in compromising the suit as is contemplated in 26 U.S.C.A. § 263(a)(1). In fact, the stock was immediately sold to Cage (the original prospective purchaser) for one million dollars, the same price contracted for in the aborted sale to Ainsworth. This is not, of course, conclusive; but it demonstrates the point that the "title" to the property was in no manner affected — only the obligation to transfer title was involved.

Treasury Regulation 1.212(1)(k), i.e., "defending or perfecting title," must be read in the light of the statutes from which it draws its authority. This manifestly contemplates some "permanent improvement or betterment" to one's legal claim to title, — not to one's claim to the right to combat the effort to force transfer of the admittedly perfect title. Title is involved; but the "defen[ce] or perfect[ion]" of title is not.

IV.

The foregoing reasons, it seems to me, whether considered singly or in combination, require that the judgment of the trial court be affirmed. I respectfully dissent, therefore, from its reversal as ruled by the majority.

A true copy

Test: EDWARD W. WADSWORTH

Clerk, U. S. Court of Appeals, Fifth Circuit

/s/ by G. F. Gamuhean

New Orleans, Louisiana MAY 2, 1963

statements alone. The taxpayer's reference in the pleadings to two motives behind the settlement would not foreclose the District Court's inquiry into the necessary question as to which motive was dominant. Since the pleadings are silent on this score, the taxpayer was entitled to prove his primary purpose. *Feinman v. A. H. Bull S.S. Co.*, 107 F. Supp. 153, 155 (E.D. Pa. 1952), *aff'd* 216 F.2d 393 (3rd Cir. 1954). He did so, and the *only* evidence on this subject was T. W. Wheeler's undisputed testimony. The District Court and not the Court of Appeals should have been the judge of the witness' candor and credibility.

There was *no evidence* on which the Court of Appeals could have thrown out Wheeler's testimony except the pleadings which were entirely consistent with his evidence. Even though every lawyer knows that any lawsuit may conceivably be lost, this does not mean that defeat was this taxpayer's primary concern. The pleadings shed no light on this topic, even though the Fifth Circuit's opinion depends entirely on those pleadings, and even if the pleadings were inconsistent with taxpayer's testimony, under Rule 15(b) of the Federal Rules of Civil Procedure the pleadings were implicitly amended when taxpayer testified on the subject and completely reviewed the matter.

Further, Wheelers' pleadings and claim for refund are not, as the majority of the Court of Appeals conceived, admissions that taxpayer settled the lawsuit solely to protect his title in the corporate stock. The italicized portions of taxpayer's pleadings and claim for refund set forth explicitly a theory that the taxpayer's funds were expended to protect the value of the stock—not the title to the stock. But even if the

majority were correct and the pleadings might be interpreted in a different light, is it possible, fair, or just that these multi-meaning pleadings should constitute conclusive admissions against the petitioner?

The Court of Appeals took what was at best an equivocal statement subject to several interpretations and expanded one aspect thereof into a conclusive admission. This violated well established rules that a supposed admission can conclusively establish facts only if the statement is clear and unequivocal. *United States, States Fidelity & Guaranty Co. v. Carr*, 242 S.W.2d 224 (Tex. Civ. App. 1951, err. ref.); *Griffin v. Superior Insurance Company*, 161 Tex. 195, 338 S.W. 2d 415 (1960); *The Doyle*, 105 F.2d 113, 117 (3rd Cir. 1939). The unitalicized portions of taxpayer's pleadings are not unequivocal admissions which could have justified the Court of Appeals reversal of the District Court's findings of fact, based on all of the evidence, as being clearly erroneous.

The number of cases which consider a plaintiff's right to plead alternate and inconsistent grounds for relief are understandably few because no court has ever questioned the right allowed by Rule 8(e) of the Federal Rules of Civil Procedure, and, prior to the decision below, the right had never been limited. E.g. *United States v. Borin*, 209 F. 2d 145 (5th Cir. 1954), *cert. den.* 348 U.S. 821. State rules have long permitted inconsistent allegations to be included within a party's pleadings without such pleadings constituting judicial admissions. E.g. *Houston, E. & W. T. Ry. Co. v. DeWalt*, 96 Tex. 121, 70 S.W. 531, 537 (1902). The Court of Appeals cited no authority to support its holding and petioner has diligently searched

without success for any authority which would justify the Court of Appeals' harsh treatment of petitioner's claim for refund and complaint. This seems to be the only case since the adoption of the Federal Rules of Civil Procedure, and even before, in which alternate grounds alleged in the complaint have been used as conclusive judicial admissions against the plaintiff. Such a departure by the Court of Appeals from this Court's plain policy and directive enunciated in Rule 8 of the Federal Rules of Civil Procedure should not be sanctioned. *Beacon Theaters, Inc. v. Westover*, 359 U.S. 500 (1959).

(C) The opinion of the Court of Appeals reveals that the majority either disregarded *all* of the evidence or declined to consider *any* evidence which supported the District Court's findings of fact. The Court of Appeals' refusal to respect the record in this case, which supported beyond question the trial court's determinations, amounted to a trial de novo on appeal in defiance of Rule 52(a) of the Federal Rules of Civil Procedure (28 U.S.C.A.) which provides that: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Judicial disregard of the evidence of this case was a rank injustice to this petitioner and, if permitted to continue in other cases in the future, will enlarge the limited scope of judicial review so that judicial findings of fact will have no significance. (*See, eg., June T., Inc. v. King*, 290 F.2d 404, 405 (9th Cir. 1961).

The District Court's findings of fact (T. 171) set forth on page 6 of this brief were each sup-

ported by undisputed testimony or stipulation between the parties. We have included as Appendix D, *infra*, page 50, an analysis of the testimony and documentary evidence sustantiating the District Court's Finding of Fact XVIII which the Court of Appeals held to be clearly erroneous. The Appendix is 10 pages long, a substantial record, not subject to cavil or challenge. Because of the depth and bulk of the evidence which the Court of Appeals had to overcome to justify a reversal of the trial court's findings, the Court of Appeals did not attempt to deal with the evidence at all. It simply ignored the record and rested completely upon the alternate pleadings in the petitioner's claim for refund and complaint, which have been discussed in the two preceding sections. The Court of Appeals' cavalier disregard and contempt for the substantial evidence supporting the trial court's findings of fact should not be tolerated.

The only factual area which the Court of Appeals deigned to consider was the merit of Ainsworth's suit for specific performance. The Court stated at page 6 of its opinion (T 201; Appendix A, p. 36) that, "The only evidence tending (to show that the suit for specific performance lacked merit and that taxpayer settled primarily to prevent the receivership) was the taxpayer's testimony that 'the attorney told me that I could win that specific performance thing hands down'." This passage illustrates the deliberate refusal of the Court to consider the abundant evidence which supported the trial court's finding that, "The reason T. W. Wheeler made the payment of $54,675.95 to H. E. Ainsworth at the time of the settlement of said law suit, was to prevent the appointment of a receiver

over the corporations." (T 171) This evidence is set forth in detail in Appendix D on page 50 so that this Court may determine the egregious nature of the Court of Appeals' determined drive to overturn the District Court's Findings of Fact as clearly erroneous despite all of the evidence which would support such findings.

Although the Court of Appeals can reverse the findings of the District Court as clearly erroneous, if on reviewing the *entire* evidence it was left with a definite and firm conviction that a mistake had been committed. *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 396 (1948); *Grace Bros., Inc. v. Commissioner*, 173 F.2d 170 (9th Cir. 1949), the opinion of this Court of Appeals shows that it *did not* consider or appreciate the entire record. Instead, it overlooked the overwhelming documentary and testimonial evidence which justified the District Court's findings of fact and derived its "conviction that a mistake had been committed" solely from the pleadings. As shown in the preceding sections of this brief, petitioner's alternate grounds for refund were not conclusive admissions against petitioner's interest and, however they might be interpreted, could not overcome the substantial evidence which supported the findings. If this flimsy bit of "evidence" is sufficient for the Court of Appeals to reverse the trial court's findings of fact, then Rule 52(a) of the Federal Rules of Civil Procedure and the "clearly erroneous" test have been emasculated.

II

THE COURT OF APPEALS DID NOT CORRECTLY DECIDE AN IMPORTANT QUESTION OF FEDERAL TAX LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

The claim for refund here in question was made under § 23 (a) (2) of the Internal Revenue Code of 1939, which now corresponds to section 212 (2) of the Internal Revenue Code of 1954. The Court of Appeals apparently decided that the ordinary and necessary expense incurred by taxpayer in defending and settling a suit which involved, among other things, the specific performance of a contract to sell stock was not deductible as a business expense because it was "a capital expenditure" under § 24 (a) (2) of the 1939 Code (now embodied in § 263 (a) (1) of the Internal Revenue Code of 1954).

Judge Cameron in his dissent correctly highlighted the basic fallacy of the majority's decision, which was reached without any consideration of the crucial legal issue involved, when he stated that: "Even if the settlement were made to defeat the specific performance suit rather than to prevent receivership, I do not conceive of this as an expense incurred "in *defending* or *perfecting* title to property", as contemplated in the Regulation relied upon by Appellant." (T 211, Appendix A, *infra*, p. 45.) The ramifications of this issue are significant and the decision by the Court of Appeals for the Fifth Circuit will have great impact on future economic decisions by American taxpayers.

The Court of Appeals purportedly followed this Court's decision in *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 595 (1943) that, "The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of the words of § 23(a)." Unfortunately, while giving lip service to this Court's guideline stated in the Interstate Transit Case, the Court of Appeals actually held that the mere form of the suit and not its substance was decisive. This seems to be the only conclusion to be drawn from a holding that a payment is a "capital expenditure" if "it directly involved title" to anything, regardless of the real issue involved.

Even if taxpayer incurred the expense in question primarily or even solely to defeat the specific performance aspect of the lawsuit - - a fact which the trial judge specifically refused to find (T 178) - - nevertheless, the Court of Appeals' decision is erroneous because defense against a suit for specific performance under the facts of this case was an expenditure for, "The management, conservation or maintenance of property held for the production of income" and not for a permanent improvement, did not increase the value of the property, and did not defend or perfect title to property. The facts conclusively demonstrate that taxpayer's sole motive and reason for refusing to convey his stock to Ainsworth was to protect the value of that stock. The origin of that refusal and the nature of the lawsuit arising out of taxpayer's refusal to convey the stock, was the desire to prevent raids upon the corporation's assets and corresponding devaluation of taxpayer's stock, which could be returned to him by Ainsworth without any personal liability. The stipulated evidence,

the contract of sale, collateral pledge agreement, and the undisputed testimony, which are reviewed in Appendix D, infra, prove that had petitioner completed the sale of stock, Mr. Ainsworth could have depleted the assets of the companies, ruined their credit and goodwill, and then stepped out of the picture by returning to taxpayer the devalued stock which would have been additionally burdened by a first lien to the Capitol National Bank of Austin, Texas for up to $250,000.00 -- an amount in excess of Ainsworth's initial downpayment to the petitioner. Thus, petitioner's efforts to resist the suit for specific performance sought to preserve the value of property rather than to defend title to it. Even though Ainsworth's lawsuit involved a question of equitable title (and a host of other questions also), the "origin and nature, not the legal form" of the suit was taxpayer's effort to preserve and conserve the value of his property.

Institution or defense of a lawsuit involving property, and therefore involving title to that property, does not necessarily constitute a capital expenditure within the meaning of the applicable provisions of Internal Revenue Code of 1939, Ch. 1, § 24(a)(2), 53 Stat. 16 (now Internal Revenue Code of 1954, § 263(a)(1)), Treasury Regulation § 39.24(a)-2(a), or Treasury Regulation 1.212(1)(k). As Judge Learned Hand stated in *Levitt & Sons, Inc. v. Nunan*, 142 F.2d 795 (2nd Cir. 1944):

"... But it is clearly a mistake to take the face of the claim as a test of whether a payment is a cost of defending a title. If the payment is to be reckoned as such, it must be in fact made for the purpose of relieving the

property of some lien or other hostile interest." 142 F. 2d at 797.

All prior Court decisions construing Sections 212 and 263 of the Internal Revenue Code, their predecessor statutes, and the regulations thereunder have limited Treasury Regulations 1.212(1)(k) and all prior and related regulations to situations where the claimant either asserted that he had title or at one time was possessed of it. If the Court of Appeals' view that the defense of a suit for specific performance of a contract to sell personal property involves the defense or perfection of title remains unchallenged, it will be a radical expansion of Treasury Regulation 1.212(1)(k)—not based on precedent or logic.

In this case, Mr. Ainsworth did not "attack" or "deny" taxpayer's title; he tried to force transfer of it to him. Taxpayer did not defend the title to his stock; he defended against the validity of the contract upon which Mr. Ainsworth sued. As Judge Cameron observed:

"Treasury Regulation 1.212(1)(k), i.e., 'defending or perfecting title,' must be read in the light of the statutes from which it draws its authority. This manifestly contemplates some 'permanent improvement or betterment' to one's legal claim to title,—not to one's claim to the right to combat the effort to force transfer of the admittedly perfect title. Title is involved; but the 'defen(ce) or perfect(ion)' of title is not."

Suits for specific performance of a contract to sell property must be distinguished from lawsuits which actually require a defense of title or the elimination of a cloud upon title. The defense of a suit for specific

performance as a matter of law is made for the purpose of preserving and protecting the value of the property in question. Even if the foregoing proposition cannot be stated invariably as a rule of law, under the facts of this case it is incontestable that the taxpayers defended against Mr. Ainsworth's suit for specific performance solely because they wished to protect and conserve the value of their property held for the production of income. By ignoring the basic problem raised in the *Levitt* case, the decision of the Court of Appeals tends to erase the shadowy area dividing business from capital expenditures by throwing all questions involving property into the category of capital items regardless of the substance of the payment.

The confusion and perplexity which has resulted already from the Court of Appeals' somewhat cloudy opinion is demonstrated by the headnote which precedes the reported case at 311 F.2d 60, where it is stated that the payment in question by taxpayer in compromise and settlement of the Court's action was a capital expenditure if not made *solely* to prevent appointment of a receiver. Although the commentator's headnote is probably erroneous, it seems that the Court concluded that the payment was a "capital expenditure" if the primary or substantial reason behind the petitioner's settlement was to defeat the specific performance suit. This decision conflicts with the cases from other jurisdictions and from the Fifth Circuit itself.

Beer v. United States, 132 F. Supp. 282 (S.D. Ala. 1955), also involved a contract for the sale of personal property. When the sellers refused to consummate

the sale, they were subjected to the threat of a suit for the appointment of a receiver and a claim by the purchaser that he was entitled to specific performance. The Court held that $30,000 paid in settlement of the suit, and $1,000 paid for attorney's fees were ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation or maintenance of property held for the production of income.

In *Allen v. Selig*, 200 F.2d 487 (5th Cir 1952) Chief Judge Hutcheson held that a taxpayer could deduct reasonable legal fees and incidental expenses incurred in connection with a suit brought by her against the executors of her husband's estate to obtain a declaration that she was an equal owner with him of real estate, the legal title to which was in his name at his death. Her claim was that the expenses were deductible under Section 23(a)(2) of the Internal Revenue Code as incurred and paid for the management, conservation or maintenance of property held for the production of income. The Commissioner contended that the expenditures were incurred for the purpose of protecting or defending the taxpayer's title to her undivided one-half interest in the real estate. The District Court found that:

> "Title to the real estate was taken in the name of Simon Selig, but it was at all times understood that the Plaintiff owned a one-half undivided interest in it."

In our case all the facts show that taxpayer had title to the stock. As in the *Allen v. Selig* case, taxpayer was not defending title, but was conserving income-producing property, which was already owned, and freeing the

management of it from unwarranted fetters.

Since the attorneys' fees in the amount of $1,965.46 were admittedly paid in connection with the Ainsworth suit (T. 110), they are legal expenses incurred for the management or conservation of property held for the production of income, and are deductible. *Trust of Bingham v. Commissioner*, 325 U.S. 365, (1945).

It has been shown that title to the stock was not in issue in the suit filed by Ainsworth, and *Toms*, P-H Tax Ct. Mem. § 46062 (1946) is clearly in point for the proposition that legal fees incurred in the defense of a suit for breach of contract for the sale of stock are deductible.

The case of *Rassenfoss* v. *Commissioner*, 158 F. 2d 764 (7th Cir. 1946) is more nearly in point. In that case, the Court held that legal fees and expenses incurred by a co-partner were deductible as ordinary and necessary business expenses where the partnership and its two partners had been sued for appointment of a receiver, accounting and dissolution of the partnership. Title to the partnership properties was involved since the complaining party was actually found to be entitled to a small interest therein.

In many cases, monies paid to obtain releases or cancellations of legal obligations are deductible as business expenses. In its most favorable light for the Commissioner, the Wheeler-Ainsworth transaction deals with a legal obligation on the part of Mr. Wheeler to transfer the stock to Mr. Ainsworth. Mr. Wheeler neglected to fulfill this legal obligation, so Mr. Ainsworth brought suit against him. In complete settlement of the

lawsuit, cancellation and release of this obligation. Mr. Wheeler then paid Mr. Ainsworth the monies in question.

In the case of *Troc, Inc. v. United States*, 126 F. Supp. 786 (N.D. Ohio 1954), the taxpayer, as lessee, exercised an option to purchase a piece of real estate at $60,000. The market value at the time was $45,000. The option was exercised in order to acquire the property and thus rid the taxpayer—lessee—from a burdensome lease. It was held that the $15,000 difference between the market value of the property and the option price could be deducted as a business expense. The opinion followed the case of *Cleveland Allerton Hotel, Inc. v. Commissioner*, 166 F.2d 805, (6th Cir. 1948) covering a similar situation. In the latter case, it was found that the primary purpose in paying the excessive purchase price was to obtain release from the burdensome leasehold obligation. Again, as in the case of Mr. Wheeler, the payment constituted a payment to obtain release from a legal obligation for business considerations.

A case close in point is the case of *Olinger Mortuary Association v. Commissioner*, 23 B.T.A. 1282. In this case the taxpayer needed certain pledged stock so that it could repledge it to obtain funds. It paid $12,500 to obtain a release of the stock. The Court held that the amount paid to get release of the stock was deductible. Here, again, there is the case of an amount paid to obtain a release from or cancellation of a legal obligation. A further case allowing the deduction of amounts paid for release from a contract is that of *Stewart Company v. Commissioner*, 9 T.C.M. 585, aff'd 52-1 U.S.T.C. 9236. This case involved a

release from an exclusive sales contract, the use of a name, trademark and other things. The Court stated:

> "It is well settled that payments made to secure relief from an onerous contract are deductible as ordinary and necessary business expenses under Section 23(a) of the Internal Revenue Code."

If the Court of Appeals is correct in its holding that the single issue of title to property makes all legal and settlement expenses capital expenditures without regard to the question actually being litigated or the reason for the litigation, then almost no litigation expense can be a deductible expense for the preservation, conservation or management of property. Pursuing the Court of Appeals' logic to its ultimate, the defense of any suit for monetary damages is a defense of the property of the defendant which would be subjected to execution to satisfy a judgment, is a defense of property, a defense of title to property, and would therefore be a nondeductible capital expense.

The implied holding of the majority opinion of the Court of Appeals which was necessary to its disposition of the case cannot be justified by the express language of the governing statute that, "no deduction shall in any case be allowed in respect of . . . any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." Internal Revenue Code of 1939, Ch. 1, § 24(a)(2), 53 Stat. 16 (now Internal Revenue Code of 1954, § 263(a)(1)). Treasury Regulation 39.24(a)-2 draws its authority from § 24 of the 1939 Code and should therefor be limited to prohibiting the deduction of expenses incurred to improve or better

title to property. Construction of Treasury Regulation § 39.24 (a)-2 or of Treasury Regulation § 1.212 (1) (k) to apply to suits for specific performance of contracts involving personal property exceeds the statutory authority and is not permissible. In this case, the taxpayer did not improve or perfect his title in any way and this fact is proven by the taxpayer's sale of the stock to Ben Jack Cage for one million dollars - - the exact amount of money which he had originally agreed to accept from Mr. Ainsworth.

CONCLUSION

The ruling below injects uncertainty and inconsistency into the tax system. It is, in addition, a drastic departure from the heretofore accepted standards governing judicial review and improperly treats one of the alternate grounds for refund advanced by taxpayer in his claim for refund and in his complaint as a conclusive judicial admission in defiance of Rule 8 of the Federal Rules of Civil Procedure and rulings of this Court. Further, the Court below incorrectly decided an important question of Federal tax law. This petition for a Writ of Certiorari should therefore be granted.

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[3] Even if this Court should decide that the Court of Appeals' interpretation of § 23 and 24 of the Internal Revenue Code of 1939 was correct, the foregoing shows the petitioner should not be penalized for alleging alternatively in his claim for refund and complaint one correct legitimate ground for refund and another ground which is ultimately held to be invalid.

Respectfully submitted.

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APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT
No. 19178
UNITED STATES COURT OF APPEALS

Appellant,

versus.

T. W. and EVELYN B. WHEELER,

Appellees.

Appeal from the United States District Court for the Western District of Texas

(December 11, 1962)

Before RIVES, CAMERON and GEWIN, Circuit Judges.

RIVES, Circuit Judge: This appeal involves the question whether $56,641.41 paid [1] by appellee taxpayer [2] in compromise and settlement of a state court action charging him with breach of a contract [3] to sell the controlling stock interest in three corporations constituted nondeductible capital expenditures to be added to the cost basis of the stock or currently deductible expenses.

The district court sitting without a jury, found: "That the reason T. W. Wheeler made the payment of $54,675.95 to A. G. Ainsworth at the time of the settlement of said law suit, was to prevent the appointment of a receiver over the corporations." The court

[1] Including $1,965.46 paid as attorneys' fees in defending the suit and effectuating the compromise.

[2] Evelyn B. Wheeler is a party to this action only because she and her husband filed a joint income tax return. Therefore, in this opinion "appellee" refers only to T. W. Wheeler.

[3] The complaint prayed for appointment of a receiver, temporary restraining orders and injunction, general reliefe as ffor damages and specific performance.

thus concluded that the payments were an ordinary and necessary expense paid for the management, conservation or maintenance of property held for the production of income; [4] rather than a nondeductible capital expenditures as defined by the statutes [5] and as more particularly distinguished in the Treasury Regulation [6] upon which appellant relies.

Appellant contends that the subjective motive of the taxpayer in making the settlement was immaterial, but that the nature of the suit settled is the crucial test. In the alternative, appellant contends that the findings of fact are clearly erroneous. Appellee takes the position that, inasmuch as the district court found as a matter of fact that the settlement was made to prevent a receivership, the only question for review here is whether the district court's findings of fact are clearly erroneous. . . .

In 1953 appellee owned the controlling stock interests in three corporations and was negotiating a sale of the stock to one Cage. The sale was not consummated because one Phinney, Cage's attorney, informed appellee that Cage was no longer interested in buying

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[4] Deductible from net income under 26 U.S.C.A. § 212(2) 1964 Code: "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year —

"(2) for the management, conservation, or maintenance of property held for the production of income" (§ 23(a) (2) I.R.C. 1939).

[5] 26 U.S.C.A. § 263(a) (1):

"(a) *General rule.* No deduction shall bee allowed for —

"(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or este . . ." (§ 24(a) (2) I.R.C. 1939).

[6] Treasury Regulation 1.212(1), (k):

"Expenses paid or incurred in defending or perfecting title to property, in recovering property. . ., or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. . ."

the stock. However, Phinney told appellee that one Ainsworth was interested in buying the stock.

A contract for the sale of the stock to Ainsworth was executed in May 1953. The purchase price was to be one million dollars and was to include two hundred thousand dollars down payment with the balance to be paid in installments. The two hundred thousand dollars was to be obtained by the purchaser from a bank and a deed of trust on the corporation's property was to be given the bank as security. Ainsworth was to pledge the stock (subject to the deed of trust) to appellee as security for the eight hundred thousand dollar balance. Attorney Phinney, according to appellee, served as attorney for both parties in the transaction.

The final paragraph of the note which was to evidence Ainsworth's obligation to appellee is as follows:

> "No recourse shall be had for the payment of the principal or interest on this note against A. G. Ainsworth, his heirs, executors or administrators, whether by virtue of any constitution, statute or rule of law, or by the enforcement of any assessment, or penalty or otherwise, all such liability being, by the acceptance hereof, expressly waived and released, it being understood that the holder of this note shall look solely to the security [the stock pledged] for said note for payment."

Appellee testified that, before the contract was signed, he asked the attorney if the above quoted clause would not relieve the purchaser of any personal obligation to pay the note. He said that Phinney, acting as attorney for both parties, said it would not, assur-

ing appellee that the purchaser would be personally responsible for the eight hundred thousand dollar balance. Appellee then signed the contract.

However, upon showing the contract to friends and another attorney, appellee was advised that he had been duped. He discovered that Cage, the man originally interested in buying the stock, was still interested and had not told Attorney Phinney that he was not interested, but was ready and willing to pay one million dollars for the stock. Appellee believed that if he performed the contract, Ainsworth would probably "bleed" the corporate assets by paying personal salaries, expenses and perhaps dividends, then turn the stock back with the corporation's assets depleted by these withdrawals, all without any personal liability to the purchaser, Ainsworth.

Appellee refused to consummate the sale, and Ainsworth brought suit in a Texas state court, setting out the terms of the contract, complaining that appellee had breached the contract and praying that appellee be enjoined from selling the stock, that a receiver be appointed, and asking for specific performance, damages and general relief.

The district court found as facts that credit was at all times indispensable to appellee in the operation of the corporations, that appellee believed that the appointment of a receiver would cut off all credit to the corporations, and that the payment of the money in settlement was made to prevent the appointment of a receiver. The court concluded that the sums paid out were ordinary and necessary expenses paid for the management, conservation and maintenance of property

(the stock) held for the production of income, and thus deductible expenses rather than capital expenditures.

Appellee, taxpayer urges that the district court's finding of fact that the reason he made the settlement was to prevent the appointment of a receiver over the corporation is not clearly erroneous, and that the taxpayer's subjective motive for settling the suit is material in distinguishing between deductible expenses and capital outlay, and relies principally upon *Levitt & Sons, Inc. v. Nunan*, 2 Cir., 1944, 142 F. 2d 795. The appellant insists that the subjective motive of the taxpayer is irrelevant, that the nature of the suit itself and of the compromise agreement is dispositive.[7]

It seems to us that the finding by the district court and the argument of counsel place undue emphasis upon the reason or subjective motive of the taxpayer, and that the real question is what was the substance as distinguished from the legal form of the transaction. As said in *Interstate Transit Lines v. Commissioner*, 1943, 319 U.S. 590, 594: "The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of the words of § 23(a)."

Conceding that the taxpayer's reason or motive may be considered in determining the real substance of the transaction, it certainly cannot be so considered to the exclusion of the objective facts. Those facts leave us in no doubt that the suit which was settled was a suit for specific performance and directly involved title

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[7] Citing Lewis v. Commissioner, 2 Cir. 1958, 253 F. 2d 821, 824, 825, 826, n. 5; United States v. General Geophysical Co., 5 Cir., 1961, 296 F. 2d 86, 90; Brown v. Commissioner, 5 Cir., 1954, 215 F. 2d 697, 700; Arcadia Refining Co. v. Commissioner, 5 Cir., 1951, 118 F. 2d 1010.

to the stock in question. It was based on a written contract signed by the taxpayer. The district court made no finding that Ainsworth's claim for specific performance had no foundation. No attorney so testified. The only evidence tending to that conclusion was the taxpayer's testimony that, "the attorney told me that I could win that specific performance thing hands down." To conclude from a client's understanding of his attorney's optimistic prediction of victory that the attack on title lacked substance would indeed be farfetched.

The first intimation of such an impression is in the taxpayer's testimony upon the trial of this tax refund suit. Actually the taxpayer was already committed to the fact that he settled the case to prevent the possibility of losing the case and being required to specifically perform his contract. Attached to his formal claim for refund was a statement of "Grounds for Claim," which included the following:

> "Taxpayer made such settlement to prevent:
>
> "(1) the possibility of losing the case which would force him to complete the contract and cause a tremendous reduction in the value of his property held for the production of income. Taxpayer before the contract was entered into had property held for the production of income (capital stock) amounting in value to $1,000,000.00. Should taxpayer have been forced to fulfill the contract of sale his property held for the production of income would have been converted into property (promissory notes) which he feared would have a value much less than their face value due to the anticipated action of the purchaser. Taxpayer

wanted to protect his property held for the production of income (capital stock) and to conserve it.

(2) the possibility of placing the corporation in receivership which would damage the corporations heavily, financially and their good-will, and cause taxpayer's property held for the production of income (capital stock) to decrease in value accordingly.

"Section 212 of the Internal Revenue Code allows as expenses all ordinary and necessary expenses paid for the management, conservation or maintenance of property held for the production of income. Taxpayer's sole reason for payment of such settlement was to protect and conserve such capital stock, his property held for the production of income."

Likewise, taxpayer's complaint instituting the present action alleged

IX

"Taxpayers made such settlement to prevent the possibility of losing the case which would force them to complete the contract and cause a tremendous reduction in the value of their property held for the production of income, and to prevent the possibility of placing the corporation in receivership which would damage the corporations heavily, financially, and their good will, and cause taxpayers' property held for production of income to decrease in value accordingly."

In the face of these record commitments, it cannot now be successfully urged that taxpayer's reason for making the settlement was substantially or solely to prevent the appointment of a receiver. That does not accord with the objective facts or with the taxpayer's own statements. We conclude that the payments in question were made by the taxpayer in defense or protection of his title to the stock that was the subject of the suit for specific performance, and were therefore capital expenditures.

The judgment is therefore reversed and the cause remanded.

REVERSED AND REMANDED

CAMERON, Circuit Judge, Dissenting:

I.

It seems to me, with deference, that the basic holding of the majority opinion is that the findings of fact of the court below must be set aside as clearly erroneous. The opinion in effect concedes that appellee, T. W. Wheeler, gave testimony in direct support of the finding of the court below "that credit was at all times indispensable to appellee in the operation of the corporations, that appellee believed that the appointment of a receiver would cut off all credit to the corporations, and that the payment of the money in settlement was made to prevent the appointment of a receiver." [1]

[1] When asked "Specifically why did you pay the money?" appellee T. W. Wheeler responded:

"A. Well, the attorney told me that I could win that specific performance thing hands down. But when they go to placing my business in the hands of the receiver, I am bankrupt — my creditors — I am cut off, because at that time I needed all the bank credit I could get. I was borrowing money every day. Every day we were borrowing money on our accounts receivable to keep going the next day. It meant — you put that receiver up there — I am cut off at both ends. I am out of business."

The majority does not, as I understand it, intimate that there was any testimony given by any witness refuting that given by appellee. Nor does it advert to the finding of the trial court that the settlement was made "immediately prior to the hearing on A. G. Ainsworth's application for a temporary injunction and the appointment of a temporary receiver . . ." It rests its conclusion rather upon the postulate that the testimony was inconsistent with two writings, appellees' claim for refund and their complaint filed in this action. These documents do not, in my opinion, constitute a sufficient refutation of the undisputed testimony, supported by the circumstances attending the settlement, to warrant setting aside the findings of the trial court as clearly erroneous.

The claim for refund embraced every theory which the taxpayer desired to present as the basis for allowance of the claim, and was, in reality, largely a legal argument. Paragraph (2) of the claim, as quoted in the majority opinion, shows that the prospect of the placing of the corporations in receivership was an important consideration in the making of the settlement and was one of the bases asserted for appellees' claim for refund. The inclusion of the other grounds does not, in my opinion, weaken the fact that the appellees were explicitly relying on the threat of receivership, which the court below found to be the basic reason behind the settlement.

The same thing is true of the complaint appellees filed. It is true that, as quoted in the majority opinion, the complaint asserted that the taxpayers made the settlement to "prevent the possibility of losing the case

which would force them to complete the contract and cause a tremendous reduction in the value of their property held for the production of income . . ." But the complaint also asserted the claim which the court below found to be the one which influenced appellees to buy their peace:

> "Immediately prior to the hearing on the purchaser's application for the appointment of a receiver, taxpayers settled the case . . .
>
> ". . . to prevent the possibility of placing the corporation in receivership : . ."

It is provided in Rule 8(e) (2), F.R.C.P., that a "party may set forth two or more statements of a claim . . . alternately or hypothetically, either in one count . . . or in separate counts . . ." It is further there provided that a "party may also state as many separate claims or defenses as he has regardless of consistency . . ." And this Court has held consistently that cases should be decided on the evidence rather than the pleading.[2]

The court below heard the evidence and the statements of counsel for the respective parties made to the court during the production of the evidence;[3] and I do not believe that the two writings upon which the majority relies are sufficient to overturn its findings on this issue of fact.

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[2] See, e.g., Des Isles v. Evans et al, 5 Cir., 1952, 200 F. 2d 614, 616: "Under the Rules of Civil Procedure a case consists not in the pleadings, but the evidence, for which the pleadings furnish the basis. Cases are generally to be tried on the proofs rather than the pleadings."

[3] Including the statement of appellees' attorney: " : . . our position is that Mr. Wheeler didn't pay the money to get out from under this specific performance, but he paid it to prevent the receivership, which he has just testified to."

II.

As I understood the argument made before us, the appellees thought that the case most directly in point was *Levitt & Sons, Inc. v. Nunan*, 2 Cir., 1944, 142 F. 2d 795, and the appellant seemed to concede that this case did support the position of appellees. In its brief, appellant stated "that the language of the *Levitt* opinion is sufficiently broad for application here." In that case, one Edelman made demand upon the taxpayer for an accounting of certain unspecified real property, and proceeds from the sale of real property, then in the taxpayer's possession. The taxpayer settled the claim for sixty-five thousand dollars and the question on appeal was the same as that before us here; i.e., was the money paid out a deductible expense or a nondeductible capital expenditure incurred in the defense of title to be added to basis.

Judge Learned Hand gave the opinion of the court, which reads in part:

> "The Levitts retained an attorney who examined the facts and reported that the claim was *utterly baseless and made in bad faith;* in substance, merely blackmail. However, an accountant whom they had long employed and whose judgment they trusted thought that the company *could not afford to be subjected to the dangers of such a suit, regardless of its lack of merit.* Its affairs were in solution, and precipitation might ruin them; it had on hand many unfinished transactions, sales, building contracts and the like, and a *shock to its credit might prove far more disastrous than a large sum paid in settlement*, however unnecessary that was

actually to protect its title. This argument prevailed, and Edelman was paid $65,000 for a release by himself and those whom he represented. The tax court concluded that the claim had been *'to recover from petitioner property to which it had no title.* And, if the agreement to pay * * * was to settle *a claim of that nature*, the payment must be regarded as a payment to get rid of a claim against some of the assets of petitioner.' Again, that the claim was 'against petitioner as the recipient of property and proceeds * * * which Edelman believed should have gone to stockholders of Rockville.' It also held (as an alternative we must suppose), that 'to incur an expense to avoid such uncertain contingencies as petitioner's officers believed would result if Edelman filed an action * * * involving such groundless claims was neither an ordinary or (sic) a necessary step for petitioner to take in the conduct of its business.' * * *

"The judge did indeed find that Edelman claimed an equitable interest in the taxpayer's property, and we agree, as we have said. * * *" [Emphasis supplied.]

With respect to the government's contention that the payment was made as a cost of defending or protecting a title to property, the Court said:

"* * * But it is clearly a mistake to take the face of a claim as a test of whether a payment is a cost of defending a title. If the payment is to be reckoned as such, *it must be in fact made for the purpose of relieving the property of some lien or other hostile interests. The mere fact that, if it*

> *were sound in law, it would establish such an interest, does not prove that the taxpayer has paid to defend his title;* he may be completely confident that this is not peril; yet there may be other sound reasons for ridding himself of the suit. The cost of the mere contest may be more than the claimant is willing to accept; *the mere pendency of the suit may disastrously affect the taxpayer's general credit.* When that is the situation, the regulation does not cover, and the payment must be judged by some other measure. In the case at bar, if the Levitts were altogether satisfied with their lawyer's advice about Edelman's claim, if they settled with him only because they feared the effect of the publicity upon their credit, and so upon their business generally, the payment was not part of the cost of any of their property * * *." [Emphasis supplied.]

The case was reversed and remanded for further proceedings in accordance with the opinion expressed by the Court.

The case seems to me precisely in point and appellant was apparently of the same mind, devoting its efforts to the attempt to establish that, insofar as it holds that the taxpayer's subjective motive is material, *Levitt* has been overruled by implication by *Lewis v. Commissioner*, 1958, 2 Cir., 253 F. 2d 821. I do not agree.

In *Lewis*, the taxpayer was an author. He expended eleven thousand nine hundred fifty dollars in defending successfully his wife's charge in a New York

court that he was dangerously insane and resisting her attempts to have him committed. The taxpayer argued that the expenditures *were deductible business expenses rather than personal expenses* in that they were paid in protection of his trade or business, since commitment would have been detrimental to the sale of his books.

The Tax Court denied deduction, characterizing them as personal expenses, because it found that the taxpayer's primary interest was to maintain his freedom rather than to protect his business. The Court of Appeals agreed with the result of the Tax Court's decision, but followed "a somewhat different path for we cannot agree that the peculiar personal characteristics of a taxpayer are determinative of his tax liability. That one taxpayer prizes his liberty more than his property, while another values property more highly seems to us irrelevant to the allowance or disallowance of a claimed deduction." *Lewis*, at page 224-225.

That decision holds merely that the personal characteristics of the taxpayer are not relevant. It does not overrule *Levitt* in its holding that "it is clearly a mistake to take the face of the claim [against taxpayer] as a test of whether a payment is a cost of defending title." 142 F. 2d 795, 797.

The two cases do not involve the same question and are not analogous. *Levitt* was concerned with whether an expenditure was deductible or should have been capitalized; *Lewis* was concerned with whether the expense was personal or business. I am unable to

agree that Lewis implicitly overrules *Levitt*.[4]

I agree with Judge Learned Hand's reasoning in *Levitt*, and find it unanswerable in testing the main question before us. The rule that "substance, not form, controls" works for the taxpayer as well as the government. "The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of § 23(a) [now § 212 (2)]." *Interstate Transit Lines v. Commissioner*, 1943, 319 U.S. 590, 594. "The nature of the transaction * * * controls the tax effects." *Cotnam v. C. I. R.*, 1959, 5 Cir., 263 F. 2d 119, 122.

III.

But even if the settlement were made to defeat the specific performance suit rather than to prevent receivership, I do not conceive of this as an expense incurred "in *defending* or *perfecting* title to property," [emphasis added] as contemplated in the Regulation relied upon by appellant. This case strikes me as one in which the government fails to see the forest for the trees. The Regulation on which the government bases its claim must be read in the light of the statutes with which it is in *para materia*.

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[4] In fact, Lewis cites Levitt as authority on another point at page 827. See also Rassenfoss v. Commissioner, 1946, 2 Cir., 158 F. 2d 764; and Hochschild v. Commissioner, 1947, 2 Cir., 161 F. 2d 8817, in which claims to title were incidentally involved and deductions were allowed. Cf. Brown v. Commissioner, 1954, 5 Cir., 215 F. 2d 697, in which this Court recognized that the purpose in making the payment was controlling, but held that proof of a purpose other than the defense or perfection of title was not made.

[5] Treas. Reg. § 1.212(1) (k). See note 6, majority opinion.

[6] 26 U.S.C.A. §§ 263(a) (1) and 212(2). See notes 4 and 5, majority opinion.

No case has been cited to us in which money spent in defeating a specific performance suit was considered money spent "in defending or perfecting title to property." Certainly, the title to the property is necessarily involved, but no more so, for instance, than is the title to property attached to secure the payment of the judgment in an ordinary suit for damages. In both cases the plaintiff or complainant *depends* on his adversary's title; he does not attack or deny the title, but desires access to the title. An alleged obligation to transfer title may be involved, but resistance to transfer is not defense of title.

We are here dealing with a Regulation distinguishing two statutes. The statutory authority from which the Regulation, T.R. 1:212(1)(k), is drawn is 26 U.S.C.A. § 263(a)(1): "*No deduction* shall be allowed for * * * (1) any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate," and 26 U.S.C.A. § 212(2): "* * *allowed as a deduction* * * * expenses * * * (2) for the management, conservation or maintenance of property held for the production of income." [Emphasis added.]

It is not claimed that this title is in any way clouded or that there is any doubt as to who is the true owner of it. It seems to me that everyone agrees that the taxpayer has a perfect title, and that all his opponent desired was to force transfer of that title to him. The expense incurred in combatting this attempted forced transfer did not touch the existing title. It related solely to an effort to protect the taxpayer against his opponent who was trying to enforce a transfer to him

Passing again the question of the legal sufficiency of petitioner's alternate theory, there can be no question that petitioner raised two grounds for relief in both the complaint and the claim for refund. Both grounds related to the motive for the settlement of the lawsuit, and it was believed at the time suit was instituted by petitioner that either or both motives justified the tax treatment of the settlement payment as a business expense. But if taxpayer (actually, if taxpayer's counsel) was wrong in one theory, the other would have supported his lawsuit. E.g., *Dubuque Fire & Marine Ins. Co. v. Wilson*, 213 F.2d 115, 120 (4th Cir. 1954); *Taylorson v. American Airlines, Inc.*, 183 F. Supp. 882 (S.D.N.Y. 1960). In any event, the Court of Civil Appeals should not have determined the merits of plaintiff's claim on the claim for refund and complaint alone, using one insufficient ground to override other legally sufficient grounds. E.g., *Grain Belt Supply Co. v. Commissioner*, 109 F. 2d 490 (8th Cir. 1940), *cert. den.* 310 U.S. 648; *Keiser v. Walsh*, 118 F. 2d 13 (D.C. Cir. 1940). In this respect, the Court of Appeals violated its own rule announced in *Sanderson v. Crowley*, 180 F.2d 124 (5th Cir. 1950), that, "An appellate court should not be too technical in respect to the pleadings in a case like this, which was fairly tried below upon the real issues between the parties, and where substantial justice has been done by the verdict and judgment under review . . ." 180 F.2d at 127.

But even assuming for the moment that the petitioner's grounds for refund were not made in the alternative -- an assumption disproved by the evidence -- the Court of Appeals was not authorized to reverse the findings of fact of the District Court on those

APPENDIX B

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1961

No. 19178

D. C. Docket No. 2727 Civil

UNITED STATES OF AMERICA,
Appellant,

versus

T. W. and EVELYN B. WHEELER,
Appellees.

Appeal from the United States District Court for the Western District of Texas

Before Rives, Cameron and Gewin, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel:

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said Ditrict Court in accordance with the opinion of this Court.

"Cameron, Circuit Judge, Dissents" December 11, 1962
Issued: March 30, 1963

APPENDIX C

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 19178

UNITED STATES OF AMERICA,
Appellant,

versus

T. W. and EVELYN B. WHEELER,
Appellees.

Appeal from the United States District Court for the Western District of Texas

(FEBRUARY 27, 1963)

ON PETITION FOR REHEARING

Before RIVES, CAMERON and GEWIN, Circuit Judges.

PER CURIAM:

The petition for rehearing in the above-styled and numbered cause is hereby

DENIED.

"Cameron, Circuit Judge Dissents"

(ORIGINAL FILED - FEBRUARY 27, 1963)

APPENDIX D

The United States District Court for the Western District of Texas found as a fact that:

> "The reason T. W. Wheeler made the payment of $54,675.95 to A. G. Ainsworth at the time of the settlement of said lawsuit, was to prevent the appointment of a receiver over the corporations." (T 171.)

The following evidence of record supported the district Court's finding.

1. Taxpayer Wheeler tesstified that he paid $54,675.95 as a settlement to prevent (a) receivership and not, to defeat the suit for specfic performance of the contract of sale.

"Q Mr. Wheeler, would you please tell the Court why you paid that $54,000?

A Yes, sir. They had an Injunction against me, and had asked that my business be placed in temporary receivership. Well, as far as the part making me go through with the contract was concerned, Mr. Robinson, my attorney, said he could win that hands down, but. . . .

MR. LITTENBERG: Now, your Honor, I will have to object to Mr. Robinson telling him he can win it hands down. . .

THE COURT: . . . Is part of your case, and part of your case, a question of intent of this gentleman in making this settlement?

MR. LITTENBERG: Not as far as the Government is concerned, Your Honor.

THE COURT: Do you feel like that as a matter of law you are entitled to the money?

MR. LITTENBERG: On the facts presented to the Court in the stipulation.

THE COURT: Because, you say, the whole matter is a suit for specific performance of the contract, and this plaintiff paid $54,000 to protect his property; that's your theory of the case?

MR. LITTENBERG: To protect - - there was an expenditure for the defense for protection of his title to the property on the basis of the suit for specific performance . . . . Now, it is not a question of his intent . . (T 88)

THE COURT: . . . What is your theory?

MR. WOODLEY: . . . our position is that Mr. Wheeler didn't pay the money to get out from under this specific performance, but he paid it to prevent the receivership, which he has just testified to.

THE COURT: All right. I will overrule the objection. Go ahead.

Q (By Mr. Woodley) Would you go ahead? Specifically why did you pay the money?

A Well, the attorney told me that I could win that specific performance thing hands down. But when they go to placing my business in the hands of the receiver, I am bankrupt, - - my creditors - - I am cut off, because at that time I needed all the bank credit I could get. I was borrowing money every day. Every day we were borrowing money on our accounts receivable to keep going the next day. It meant - - you put

that receiver up there - - I am cut off at both ends. I - n out of business. (T 89.)

Q How much money were you borrowing about that time.

A I was borrowing anywhere from twenty to fifty or sixty thousand dollars a week.

Q Was this just an out and outright borrowing, or did you have an arrangement where it sort of flowed through the corporation.

A Well, it was the corporation was borrowing the money, and what we were doing was taking our accounts receivable to the bank every day, or two or three days, and they would give us 90 percent on those accounts receivable, and the accounts receivable were then paid direct to the bank and they'd take their note out and give us the ten percent. And that would go on almost every day.

Q Well, did you feel that if a receiver was appointed for your business that your credit would be cut off?

A It sure - - yes, sir, I sure did." (T 90.)

The government's objection to the testimony was apparently based on a theory that Mr. Robinson's statements were hearsay and that the taxpayer's intent was immaterial. The Court of Appeals conceded that taxpayer's motive and intent were material, and Mr. Robinson's statements were offered only to show taxpayer's intent. Therefore, the evidence was properly admitted by the District Court. Once the evidence of taxpayer's dominant motive for the settlement was before the trial court, the court had a duty to make findings of fact based thereon. It did so. Where there is a con-

flict between admissions and other testimony, the fact must be determined by the fact finder. *State Farm Mut. Auto Ins. Co. v. Porter*, 186 F.2d 834, 844 (9th Cir. 1950); *Bruce v. McClure*, 220 F.2d 330, 336 (5th Cir. 1955). Even prejudicial judicial admissions can be and should be overridden when the Court concludes the tdmissios is incorrect. *Iravani Mottaghi v. Backey Importing Co.*, 244 F.2d 538 (2nd Cir. 1957) *cert. den.*, 354 U.S. 939. In this case, the so-called "admissions" in petitioner's pleading were not conclusive because they were not admissions, were subject to several interpretations, and were factually incomplete.

Even more important, the "admissions" may not be used to reverse the trial court's findings because under the Federal Rules of Civil Procedure, the pleadings are deemed to have been amended to conform to the evidence introduced at trial. "Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; *but failure so to amend does not affect the result of the trial of these issues.* If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits." Federal Rules of Civil Procedure, Rule 15 b (28 U.S.C.). The government never objected that the evidence of taxpayer's intent was not within the pleadings. The government's objection was based on its for-

malistic theory that, since the suit for specific performance involved title, no intent could be relevant or material. Thus, to the extent that taxpayer's pleadings can be read as an admission that he incurred the expense in question substantially for the purpose of defending his title, the introduction of the evidence to the contrary, even over the government's objection, must be treated as an amendment by the express or implied consent of the parties, and the pleadings are deemed to conform to the evidence whether formally amended or not. See eg. *Gibbs v. Randolph*, 250 F.2d 41, 43 (5th Cir. 1957); *Purofied Down Products Corp. v. Travelers Fire Insurance Co.*, 278 F.2d 439, 444 (2nd Cir. 1960); *Kuhn v. Civil Aeronautics Board*, 183 F.2d 839, 841-842 (D.C. Cir. 1950). An objection in the Appellate Court which would dispose of the cause upon a technicality in pleading is not to be favored in the view of the Federal Rules of Civil Procedure, Rule 8(f) and 15, 28 U.S.C.A., especially where the objection might have been made below and the plaintiff might have amended his complaint so as to obviate the objection. *Mitchell v. Wright*, 154 F.2d 924, 926 (5th Cir. 1946). Where the case is tried as if an issue had been raised in the original pleadings an amendment of the pleadings is not imperative. *Pearl Assur. Co. Ltd. v. First Liberty Nat. Bank*, 140 F.2d 200, 202 (5th Cir. 1944). Thus, under the rules which have heretofore applied in the Court of Appeals for the Fifth Circuit, any admissions which might have been contained in the petitioner's pleadings were amended to conform to the evidence actually produced at trial. Viewed in this light, not only was there substantia evidence to support findings

of the District Court, there was no evidence to the contrary.

2. If the petitioner's claim for refund and complaint contained any admissions, the government's pleadings also contained similar admissions that one reason petitioner settled the suit with A. G. Ainsworth was to "prevent the appointment of a receiver over the corporations." (T 178.) Can this frank statement by the government, that the taxpayer had dual motives in settling the lawsuit, be reconciled with the findings of the Court of Appeals that taxpayer had but one substantial motive? We think not.

3. The record is replete with evidence that Ainsworth could not have won an equitable action for specific performance of the contract of sale. Consequently, petitioner Wheeler was well advised to rely upon the advice of his attorney that, "I could win that specific performance thing hands down." (T 89.) And to settle only to avoid the receivership.

No maxim is better established than the doctrine that "He who comes into a court of equity must come with clean hands." For Ainsworth to have prevailed in his suit for specific performance he would have to have shown that the transaction from which his claim arose was "fair and just and that the relief itself must not be harsh and oppressive upon the defendant. Specific performance will always be refused when the plaintiff has obtained the agreement by sharp and unscrupulous practices, by overreaching, by concealment of important facts even though not actually fraudulent, by trickery, by taking undue advantage of his position, or by any other means which are uncon-

scientious; and when the contract itself is unfair, one-sided, unconscionable, or affected by any such other inequitable feature; and when the specific enforcement would be oppressive upon the defendant, or would prevent the enjoyment of his own rights; or would in any other manner work injustice." *Pomeroy's Equity Jurisprudence*, § 400, p 101 (5th ed Symons 1941). See e.g., *Willard v. Tayloe*, 8 Wall. 557, 565, 19 L Ed 501 (1870).

With the foregoing principles in mind, let us review the undisputed facts of Ainsworth's lawsuit for specific performance against taxpayer.

First and foremost, the unconscionable and unenforceable written contract between Wheeler and Ainsworth is itself in evidence (T 158-165); as are the collateral pledge agreement (T 145-156) and promissory note (T 157-158). In addition, taxpayer testified that Mr. Phinney was Mr. Ainsworth's attorney (T 83), that Mr. Phinney told him that Ben Jack Cage was no longer interested in purchasing the assets of the corporations (T 86) (whereas, in fact, he was) (T 91, 92), but that he had a man by the name of Mr. Ainsworth who was interested (T 78), that Mr. Ainsworth's attorney drew the contract and explained it to taxpayer (T 83), that such attorney told taxpayer that the contract did not mean that Ainsworth could take the corporations, completely deplete them, and hand the stock back to taxpayer in a worthless condition without liability (T 83); but, in fact, he could do just that and more. The contract of May 6, 1953, by and between T. W. Wheeler, seller, and A. G. Ainsworth, purchaser, provided that:

"The promissory note hereinabove provided for shall be secured by a pledge of stock agreement pledging the stock of the three corporations to secure the payment of said note. Seller agrees that purchaser may pledge such stock for a loan up to, but not exceeding, $250,000 including renewals or extensions, in which event seller agrees that his pledge of stock will be subject to the prior pledge of not to exceed $250,000." (T 160, 161).

It also gave Ainsworth the right to mortgage all of the real property of the corporation in order to further secure the Capital National Bank for making the loan to Ainsworth with which he made the down payment to taxpayer, in the following form:

"And provided further, nothing in this agreement shall prevent the purchaser, as owner of all of the capital stock in said three corporations, from causing said corporations, or any one or more of them, to execute as further and additional security, on any loan obtained by purchaser under the provisions of Paragraph IV, hereof, from the Capital National Bank in Austin, Texas, deed of trust on any and all realty owned by said corporation or any one or more of said corporations." (T 162).

Then, the escape clause which was drafted by Ainsworth's attorney, was couched in the following language:

"Seller agrees that in the event of default by purchaser, and it becomes necessary for seller to repossess the stock involved in this transaction, that seller will take said stock as complete payment of the remainder due on the note and will

not require any deficiency to be paid by A. G. Ainsworth, his heirs, administrators, representatives, executors, successors or assigns, and upon redelivery of stock to seller, will give a complete release of any further liability under this contract." (T 164, 165).

It was not incumbent upon Wheeler as the majority suggested, to produce an attorney to testify that the Ainsworth lawsuit could have been won under the authority of such cases as *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3rd Cir. 1948). In fact, it would have been improper to do so. The opinion of a lawyer as an expert witness on the law of the forum would not be admissible. The Trial Court must, can and did decide from the facts detailed above that the contract was not enforceable. The Court of Appeals cannot say, in the face of all the uncontradicted evidence, that the implied finding of the trial court in this regard is clearly erroneous. The Government did not request a finding of fact that the Ainsworth suit was valid or that Ainsworth would have been successful in the specific performance suit (T 175). The Court having rendered judgment for Wheeler, it must be presumed that all facts to support the judgment were found. Further, since the validity of Ainsworth's claim and suit was not contested, no finding was required. *Burkhard v. Burkhard*, 175 F.2d 593 (10th Cir. 1949); *Fontes v. Parker*, 156 F.2d 956 (9th Cir. 1946). It is an evidentiary issue at best, and requires no finding. *Skelly Oil Co. v. Holloway*, 171 F.2d 670 (8th Cir. 1948).

Finally, Mr. Ainsworth was present in the courtroom during Mr. Wheeler's testimony (T 74) and was called by the Government as a witness (T 95). Even

so, the facts related by taxpayer Wheeler stand in the record without the dispute or qualification which Mr. Ainsworth could easily have supplied had any portion of Mr. Wheeler's testimony been in error. Further, Mr. Ainsworth did not testify that he would have prevailed in his suit. Thus, there is ample evidence in the record to support the view that Ainsworth's suit for specific performance "lacked substance" and the Findings of Fact by the District Court implicitly reflect this conclusion.

APPENDIX E

STATUTES, REGULATIONS AND RULES INVOLVED

Internal Revenue Code of 1939

SEC. 23 DEDUCTIONS FROM GROSS INCOME

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

* * *

(2) [as added by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Non-trade or non-business expenses.* — In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 24. ITEMS NON DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

* * * * *

(26 U.S.C. 1952 ed., Sec. 24.)

Treasury Regulations 118 (1939 Code)

Sec. 39.23(a)-15 *Non-trade or non-business expenses.* * * *

* * * * *

(k) Expenditures incurred in defending or perfecting title to property, in recovering property * * * constitute a part of the cost of the property and are not deductible expenses. * * *

(1) The deduction of an item otherwise allowable under section 23(a) (2) will not be disallowed simply because the taxpayer also had an election under chapter 1 to treat it as a capital expenditure, rather than to deduct it as an expense. (See section 24(a) (7).) Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in chapter 1, no deduction is allowable under this section; and this is true regardless of whether any basis adjustment is allowed under section 113.

* * * * *

Sec. 39.24(a)-2 *Capital expenditures*—(a) *Expenditures except non-depreciable mine development ex-*

penditures. * * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

* * *

Internal Revenue Code of 1954

SEC. 7422. CIVIL ACTIONS FOR REFUND.

(a) No suit prior to filing claim for refund. - - No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or for any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof.

SEC. 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) *General Rule.* - - In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person.

Treasury Regulations (1954 Code)

Sec. 301.6402-2 *Claims for refund or credit (a) Requirement that claim be filed* (1) Credit or refunds of Overpayments may not be allowed or made after the

expiration of the statutory period of limitation properly applicable unless, before the expiration of such period, a claim therefor has been filed by the taxpayer . . . (b) *Grounds set forth in claim.* (1) No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof . . . A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit.

Federal Rules of Civil Procedure (28 U.S.C.)

Rule 8. GENERAL RULES OF PLEADING

(a) Claims for Relief. A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded.

* * *

(e) Pleading To Be Concise and Direct; Consistency.

(1) Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required.

(2) A party may set forth two or more statements of a claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as he has regardless of consistency and whether based on legal or on equitable grounds or on both. All statements shall be made subject to the obligations set forth in Rule 11.

* * *

Rule 15. AMENDED AND SUPPLEMENTAL PLEADINGS

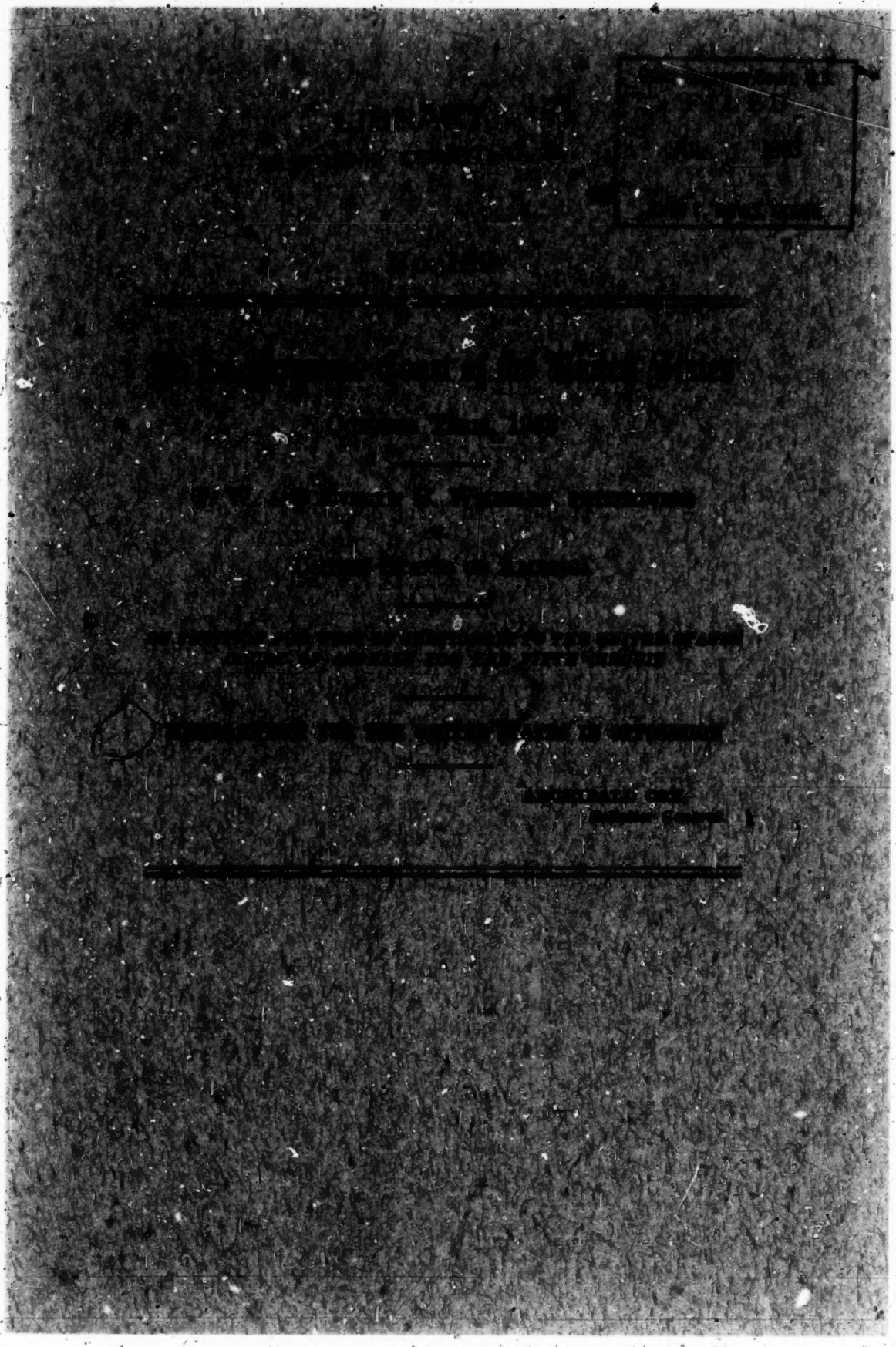
* * *

(b) *Amendments to Conform to the Evidence.* When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be

amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

Rule 52. FINDINGS BY THE COURT

(a) *Effect.* In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing intelocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.



In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 180

T. W. AND EVELYN B. WHEELER, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

1. The judgment of the court of appeals was entered on December 11, 1962. A petition for rehearing was denied on February 27, 1963. No extension of time for filing a petition for certiorari was granted, and the 90-day period for filing expired on May 28, 1963. The petition was filed on June 1, 1963, and is accordingly out of time. 28 U.S.C. 2101(c).

2. The petition in any event presents no question warranting review. The petitioner entered into a contract to sell for $1 million his controlling stock interest in three corporations. Upon discovering that under the terms of the contract the buyer was not personally liable for the purchase price, the petitioner refused

692-731—63

to perform. The buyer brought suit for specific performance. After preliminary proceedings, the petitioner settled the suit by paying the buyer $54,675. Immediately following the settlement of the suit, the petitioner sold the stock to another purchaser.

On his income tax return for 1953, petitioner claimed a deduction for the $54,675 paid in settlement of the suit (plus $1,965 in legal expenses) as "ordinary and necessary expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income" under § 23(a)(2) of the Internal Revenue Code of 1939. The court of appeals, reversing the district court, held that the amounts expended in defending and settling the suit were capital expenditures to be added to the petitioner's basis for the stock rather than current business expenses.

The decision below is clearly correct. That the buyer sought a temporary receivership of the corporation pending determination of the suit, and that a receivership might have injured the business by impairing its credit, is irrelevant. The characterization of the costs of resisting or settling a claim depends upon the source and nature of the claim, not the injurious consequences threatened by its assertion. *United States* v. *Gilmore*, 372 U.S. 39. Here the claim arose from petitioner's efforts to sell his stock, a capital asset, on the best terms available. By avoiding his contract with the initial buyer, and settling the resulting suit, petitioner was able then to sell the stock on more favorable terms. And not only did the claim

arise from a sale transaction, but in its nature the claim was an assertion of equitable title to the stock. Whether the expenditures be viewed as a cost of defending the petitioner's "title" to the stock, as a cost essentially of "reacquiring" the stock in order to permit a more advantageous sale, or simply as a cost of selling the stock (viewing the aborted sale and the completed sale as but parts of a single undertaking to dispose of the stock on the best terms available), they are properly to be recovered as an offset against the ultimate sales proceeds produced by them. In no sense do they represent the "current" costs of holding property for the production of income.

There is in any event no conflict of decisions and no other ground for certiorari. The petition should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

JULY 1963.

U. S. GOVERNMENT PRINTING OFFICE 1963

Office-Supreme Court, U.S.
FILED
SEP 16 1963
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 180

T. W. AND EVELYN B. WHEELER,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

REPLY TO THE MEMORANDUM OF THE UNITED STATES WHICH OPPOSES THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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BORG PRINTING COMPANY OF TEXAS, HOUSTON, TEXAS

In The

Supreme Court of the United States

October Term, 1963

No. 180

T. W. and Evelyn B. Wheeler,

Petitioners,

v.

United States of America,

Respondent.

REPLY TO THE MEMORANDUM OF THE UNITED STATES WHICH OPPOSES THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The United States of America has filed its Memorandum in Opposition to Petitioner Wheelers' petition for writ of certiorari and has charged as one of the two grounds of opposition that the petition was not timely filed.

As shown by Appendix I, attached hereto, said petition was mailed to the Clerk of this Court on May 24, 1963, by first class mail with proper address and postage more than four days prior to the expiration on May 28, 1963, of the 90 day time limit provided by 28 U.S.C.A., Sec. 2101(c). Evidence that the petition was posted on May 24, 1963, has been retained in the office of the Clerk. As shown in Appen-

dix II, attached hereto, the petition for writ of certiorari should have been received and filed by the Clerk of the Supreme Court in the ordinary course of mail delivery on May 27, 1963, more than one full day before the expiration of said time limit. However, due to an extraordinary transit of 8 days from the United States Post Office in San Antonio, Texas, to the Office of the Clerk of the Supreme Court of the United States in Washington, D. C., the Petition for Writ of Certiorari was received and filed by the Clerk on June 1, 1963, and was not filed within the period deemed under Rule 22(3) of the Revised Rules of the Supreme Court of the United States, as amended, to be timely for petitions for writ of certiorari. Upon learning that the petition had not been received by the Clerk by May 28, 1963, attorneys for Petitioners submitted an application to Justice Black for an extension of time within which to file the petition. Attached to the application were the orginal of Appendices I and II which are attached hereto and are now on file with the Clerk. The application for extension of time was personally delivered to the Clerk by counsel for Petitioners who traveled to Washington, D. C. to make sure that the application was received and also to present said application to Justice Black. However, counsel did not submit the application personally after being informed that it was not necessary to do so. Said application for extension of time was denied by Justice Black on June 7, 1963, with the further ruling, however, that this did "not prejudice the right of Petitioners to have the full court determine the question of the timeliness of this petition for certiorari."

Petitioners used every reasonable precaution in preparing and posting said petition for writ of certiorari so that it would reach the Clerk and be filed on or before

May 28, 1963. Furthermore, in compliance with Rule 33 (2) (a) of the Revised Rules of the Supreme Court of the United States, on May 24, 1963, counsel for Petitioners also served the Solicitor General and all attorneys of record who represented the United States by mail with copies of Petitioners' application for writ of certiorari. Service was made by mail, airmail postage prepaid, and should have been received by the Government's attorneys on or before May 28, 1963. Thus, the United States had proper notice of the Petitioners' application for writ of certiorari, and it is therefore fair to presume that all attorneys so served thought (until they received notice from Petitioners to the contrary) that said petition was filed within the time prescribed in Rule 23(3) of the Rules of the Supreme Court. Although the government now opposes the petition on the ground that it was "out of time," no possible prejudice has been suffered by the United States as a result of the filing of said petition on June 1, 1963.

28 U.S.C.A., Sec. 2101(c) provides that " . . . Any writ of certiorari intended to bring any judgment . . . in a civil action . . . before the Supreme Court for review shall be . . . *applied for* within 90 days after the entry of such judgment or decree." These Petitioners did apply for the writ within the specified 90 day period. They did so when they posted the application on May 24, 1963. Thus they did all that was physically possible for petitioners short of personally traveling 2,500 miles to the Clerk's office with the required documents. Nowhere in the statute has Congress indicated that the Supreme Court may not consider an application for a writ of certiorari which is transmitted to the Clerk and is filed after the 90 days have elapsed where—as in this case—the application was made within the 90 day period.

Congress did not require that a petition for writ of certiorari be *filed* with the Clerk within 90 days after entry of judgment; it required only that the writ be *applied for* within that time. Congress surely could have used the word "filed" had it meant to limit the Court's jurisdiction by that arbitrary standard. It did not do so.

The language employed by Congress was, Petitioners submit, in recognition of the problems of communication and transportation which litigants far distant from Washington, D. C., might encounter — such as were suffered by these Petitioners who undeniably posted their petition in time to permit its arrival in due course of mail delivery at the office of the Clerk within the time required. In order to extend the same opportunity for justice to litigants in Texas or California which is granted to parties in Washington, D. C., it is only fair and reasonable to hold that a writ of certiorari is "applied for" if the petition is posted in time to permit its transmission in due course to the Clerk within the 90 day period — even though the petition is not actually received or filed within the 90 days. These Petitioners did all that they could reasonably be required to do. Their petition should be treated as timely filed. There is no language in 28 U.S.C.A., Sec. 2101(c) to the contrary.

Rule 22(3) of the Revised Rules of the Supreme Court of the United States provides only that a petition for writ of certiorari "shall be deemed in time when it and the certified record required by Rule 21 are filed with the Clerk within the time prescribed by law." The rule does not explicitly declare a petition out of time if not filed within the time prescribed by law (which of course requires only the application for and not the filing of the petition

within 90 days). If Rule 22(3) equates *filing* with the *application* for the writ, it goes far beyond the statutory requirements of 28 U.S.C.A., Sec. 2101(c). It thereby would impose a limitation that is non-jurisdictional. Worse, it would be in derogation of Petitioners' statutory rights. This Court, charged with defining and applying the highest ideals of justice of our society, does not penalize its petitioners for errors committed by the United States Post Office. This Court does not rest its rulings on the consequences of the sometime-vagaries of our mails.

The decision of the United States Court of Appeals for the Fifth Circuit, Judge Cameron dissenting, is premised upon the assumption or holding that a taxpayer may not advance inconsistent claims for the refund of taxes paid and that alternative allegations, under Rule 8(a) of the Federal Rules of Civil Procedure, may constitute judicial admissions against the pleader. This novel and dangerous view of the Federal Rules of Civil Procedure relieved the majority below from considering the basic issues of tax law which were raised in the District Court. Although Judge Cameron, in his vigorous dissent, wrote extensively upon these tax questions as well as the majority's remarkable view of pleading in the Federal Courts, the decision below has left important tax matters hanging in limbo, and worse yet, has opened Pandora's Box for future litigants who may attempt to exercise their apparent rights under Rule 8(e) of the Federal Rules of Civil Procedure to "set forth two or more statements of a claim or defense alternately or hypothetically."

These Petitioners, and attorneys throughout the nation, should not be deprived of the clarification of the legal ques-

tions raised and created below simply because of an error in the United States Post Office, when these Petitioners delivered and properly posted their petition within sufficient time to reach the Clerk in the ordinary course of mail delivery within the time limits prescribed by law.

WHEREFORE, Petitioners respectfully request their petition for writ of certiorari be granted.

Respectfully submitted,

By .....
F. W. BAKER

RICHARD E. GOLDSMITH
1500 Alamo National Building
San Antonio 5, Texas

PAUL E. CASSEB
Majestic Building
San Antonio 5, Texas
Attorneys for Petitioners

APPENDIX I

STATE OF TEXAS }
COUNTY OF BEXAR }

Before me, the undersigned authority, on this day personally appeared FRANCIS W. BAKER, to me well known, who, after being by me first duly sworn, does depose and say as follows:

I am FRANCIS W. BAKER, a member of the Bar of the State of Texas and a member of the Bar of the Supreme Court of the United States. I was an attorney of record for T. W. and Evelyn B. Wheeler in the case styled United States of America v. T. W. and Evelyn B. Wheeler, No. 19178 in the United States Court of Appeals for the Fifth Circuit, and I represented said T. W. and Evelyn B. Wheeler in the preparation of their Petition for Writ of Certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit rendered in the above styled and referenced case.

On December 11, 1962, the United States Court of Appeals for the Fifth Circuit entered judgment against T. W. and Evelyn B. Wheeler in the above referenced case. The Wheelers' Petition for Rehearing was denied on February 27, 1963. Pursuant to 28 U.S.C.A., Sec. 2101(c), a writ of certiorari to review said judgment had to be applied for within 90 days after the entry of the order denying the Petition for Rehearing. Therefore, pursuant to the provisions of Rule 34(1) of the Revised Rules of the Supreme Court of the United States, the Wheelers were required to apply for writ of certiorari on or before May 28, 1963.

On May 24, 1963, at 4:50 P.M., I delivered a package addressed to John F. Davis, Esq., Clerk of the Supreme Court

of the United States, Supreme Court Building, Washington, D. C., to a postal collector in the lobby of the Alamo National Bank in San Antonio, Texas. Said package contained the following:

1. 40 printed copies of the Petition of T. W. and Evelyn B. Wheeler for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit;

2. A certified transcript of the record in the case;

3. 9 copies of the record printed for the use of the Court of Appeals for the Fifth Circuit in Cause No. 19178;

4. Original and one copy of my Entry of Appearance;

5. This firm's check for $100.00 in payment of the docket fee;

6. Proof of Service of the Petition for Writ of Certiorari.

Said package was sent by first class mail, certified mail number 8€2335. I affixed $18.30 postage to said package, the appropriate amount of postage for first class mail of its weight and to its destination.

On May 24, 1963, I served copies of said Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit on the attorneys for the United States as follows:

a. By mailing a copy in a duly addressed envelope, with airmail postage prepaid, to the Solicitor General, Department of Justice, Washington 25, D. C.;

b. By mailing copies in duly addressed envelopes, with airmail postage prepaid to each of Louis F. Oberdorfer, Assistant Attorney General, and Lee A. Jackson.

Meyer Rothwacks, and Douglas A. Kahn, attorneys, all at the Department of Justice, Washington 25, D. C.; and

c. By mailing a copy in a duly addressed envelope, with first class postage prepaid, to Ernst Morgan, United States Attorney, Federal Building, San Antonio, Texas.

Based upon information I have received from the Postmaster in San Antonio, Texas, it was and is my understanding that in the ordinary course of mail delivery, the Petition for Writ of Certiorari which I mailed to the Clerk of the Supreme Court of the United States for filing should have been delivered to him on or before May 27, 1963 — at least one day prior to the deadline provided for the filing of such documents in 28 U.S.C.A., Sec. *210(c)*.

.....

FRANCIS W. BAKER

SWORN TO AND SUBSCRIBED before me this ..... day of ..... 1963.

.....

Notary Public, in and for
Bexar County, Texas

APPENDIX II

UNITED STATES POST OFFICE
San Antonio 5, Texas

June 3, 1963

Mr. Richard Goldsmith
1501 Alamo National Bank Building
San Antonio 5, Texas

Dear Mr. Goldsmith:

Your first-class mail parcel, certified mail No. 862335, addressed to John F. Davis, Clerk, Supreme Court of the United States, Supreme Court Building, Washington D. C., which you stated was handed to a post office mail collector in the lobby of the Alamo National Bank Building at approximately 4:50 P.M., Friday May 24, 1963, and subsequently postmarked May 24, by this office, should have received the following dispatch and routing to the office of address if all mail connections were made enroute.

Leave San Antonio via	
Long & San Antonio Tr 8	2015 hrs. Fri.
Arrive St. Louis	2300 hrs. Sat.
Leave St. Louis via Pitts & St. L. 14	2320 hrs.
Arrive Pittsburgh	1345 hrs. Sun.
Leave Pitts, via Wash & Pitts Sr 4	2200 hrs. Sun.
Arrive Washington, D. C.	0330 hrs. Mon.

I trust that this information will be of value to you in your correspondence with the addressee in as much as you stated that he received delivery on June 1, 1963.

Sincerely yours,

Daniel J. Quill,
Postmaster

By: George T. Henderson,
Ass't. Postmaster

Note by Petitioners: Mr. Quill's letter indicated that there is only a 20 minute interval for mail connections in St. Louis. However, we have been advised by the United States Post Office in San Antonio that the train scheduled to leave St. Louis at 2320 hours on Saturday is the same train under a different designation which is scheduled to arrive in St. Louis at 2300 hours on the same day. There is, therefore, no possibility that connections might be missed in St. Louis.